



Comparative Research in Law & Political Economy

CLPE RESEARCH PAPER 21/2009 • VOL. 05 NO. 03 (2009)

Yuri Biondi

The Governance and disclosure of the Firm as an Enterprise Entity

EDITORS: Peer Zumbansen (Osgoode Hall Law School, Toronto, Director, Comparative Research in Law and Political Economy, York University), John W. Cioffi (University of California at Riverside), Nassim Nasser (Osgoode Hall Law School, Toronto, Production Editor)

Yuri Biondi

THE GOVERNANCE AND DISCLOSURE OF THE FIRM AS AN ENTERPRISE ENTITY

Abstract: Recent financial crises and scandals have focused attention on the system of governance and disclosure in a way many may never have imagined and few welcomed. Not only do reforms appear to be necessary to protect shareholders as well as other stakeholders, but also to develop a different understanding of the relationship between the financial markets and the business firm. This paper criticises two daydreams concerning the firm - as a “black-box” or an “owner-entrepreneur” -, and contrasts them to the idea of the firm as an enterprise entity. The latter implies a comprehensive approach that integrates economics, accounting, and law. The firm is then understood as a managed dynamic system, characterized by different structures of production: institutional, organizational or epistemic (related to the place and role of institutions, internal organization, and knowledge within the firm). Accordingly, the accounting system is an integral part of this framework, one that demonstrates the joint implications of economic, accounting, and legal matters within the firm. In a business affair fraught with unfolding changes coupled with asymmetries of resources, access, control and information, the accounting system copes with the economic and monetary processes generated by the whole enterprise, by representing the enterprise capital (assets and liabilities) and income (revenues and costs). In this way, the accounting system allows this special process to exist and function autonomously from (and interactively with) financial holding of shareholders’ claims traded on the Share Exchange.

Keywords: corporate governance, financial reporting and disclosure, accounting, theory of the firm, performance measurement, shareholders’ equity interest

JEL classification: G30, M40, D20, L20

Yuri Biondi
CNRS and CNAM
Preg CRG – Ecole Polytechnique
32, Boulevard Victor, F – 75015 Paris, FRANCE
Email: yuri.biondi@free.fr
Website: <http://yuri.biondi.free.fr/>

THE GOVERNANCE AND DISCLOSURE OF THE FIRM AS AN ENTERPRISE ENTITY

Yuri Biondi*

I. INTRODUCTION

During recent decades, economy and society have been framed by the rapid pace of financial markets driven by new modes of management, governance and regulation. This transformation towards financialisation may be summarised under the “shareholder value” label.¹ What do financial markets do? Unequivocally, they allow trading on shares in the form of financial entitlements which are established by law and formalise expectations and claims to financial rents.² Actually, how continued quotation on the Share Exchange comes to be the barometer of economic or societal well-being is more complicated. This has required quite a great leap from “the euthanasia of the *rentier*, of the functionless investor” (Keynes 1936, 376), involving changes in monetary and financial frameworks at policy-making and regulatory levels, changes in banking and financial activities, and changes in shareholding and management of business firms as well. The general trend has been further shaped by transnational imitation between various socio-economic environments (Williams 2000 ed.; Deeg and Jackson 2007).

Moreover, the “shareholder value” revolution has implied new beliefs and ideas driving (i) a peculiar understanding of what financial markets can actually do, together with (ii) a peculiar understanding of what they indirectly are concerned with, that is, ongoing firms having internal organisation and management.

The first point (i) relates to the efficient financial market rhetoric. Beyond its academic foundations in the latest developments of neoclassical economic theory, this rhetoric has been utilised by financial market-makers to socially construct their businesses and advertise their new financial “products” to clients and citizens. Belief in the magic of the Share Exchange has been fuelled, and firms have become the very *commodity* that trading is constructed upon. Financial markets trade on legal entitlements, whose values relate -in principle- to financial performance

*Yuri Biondi studied economics and social sciences (DES) at the Bocconi University of Milan (M.Sc.), and economic analysis and history of institutions and organisations at the Lyon2 and Brescia Universities (PhD). In France, he has taught at the universities of Lyon2, St. Etienne, and the CNAM (www.cnam.fr). He is currently tenured researcher (research fellow) for the French Institute of Research (www.cnrs.fr) and affiliated professor of corporate governance and social responsibility at the CNAM. He is the promoter and main editor of *The Firm as an Entity: Implications for Economics, Accounting, and Law* (Routledge, 2007), and co-editor, with Tomo Suzuki, of *The Socio Economics of Accounting* (Socio Economic Review, special issue, October 2007).

On 22 and 23 May 2008, he promoted and convened the Eaepe International Conference on “Governing the Business Enterprise: Ownership, Institutions, Society” at the Cnam, Paris (<http://eaepe.cnam.fr>).

¹ Froud et al. (2000) and Lazonick and O’Sullivan (2000) deal with the managerial foundations of shareholder value, whilst Boyer (2000) and Aglietta and Reberlioux (2005) provide insightful macroeconomic analyses. Clarke (2004) edits a magisterial collection on theoretical foundations of corporate governance.

² Together with shares, other sophisticated arrangements deal with the linkage of finance to socio-economic activities, including financial instruments and securities, and insurance and pension schemes.

and position of business firms.³ In order to exist in financial markets –that are nowadays considered as the centre of economy and society–, firms are reduced to financial placements (point *ii*). The peculiar market rhetoric already applied to financial markets is then replicated within the firm. The firm is understood as a bundle of net financial investments made on behalf of investors who trade on shares issued by the firm itself. In this way, shareholder value has led to reshaping of businesses and a fostering of new “best practices” involving integrated financial management (Williams 2000 ed.).

According to Karl Polanyi, classical and neoclassical economic theory and capitalism are characterised by an alleged extension of “our obsolete market mentality” to every socio-economic activity. Polanyi’s seminal work identified three “fallacious commodities”: land, money, and human work. Even though the latter enter socio-economic activities and contexts in significant ways, this does not imply either the existence of or the need for a market coordination of those activities. The same reasoning may be applied to the firm nowadays. Expanding upon Coriat & Weinstein (2008), “shareholder value” fallaciously reduces the firm to a commoditised financial placement. The firm factually is a significant socio-economic activity, but this does not imply that it is -or has to be understood as- a market. Moreover, even though trading exists on shares and other legal entitlements issued by the firm, this does not imply that the whole economy of the business firm does -or ought to- respond to that trading on a market basis.

This paper aims to address the theoretical problem with shareholder value that comes from its underlying perspective on financial markets and share-holding. Shareholder value relies on the efficient financial markets hypothesis. Investors are then considered as completely clear-sighted traders adjusting promptly and without costs to price signals, “as if” the *price system* alone framed and shaped the dynamic of both financial markets and the firm. But what happens when shares - acquired at a definite price - relate to the enterprise congeries of legal and economic systems involving flows and immobilisations that require an *accounting system* to explicate them?

Recent crises and shortcomings testify against the received wisdom of financial markets, whose magic become black (Clarke 2008). Instead of assuring ever-progressive developments in economic and social well-being, they appear to raise unaddressed issues of stability and fairness. Enterprises that were glorified by advocates of shareholder value, like Enron or the Bernard L. Madoff Investment Securities LLC, have generated unexpected and huge fraudulent losses. The advertised miracle of the “new economy” becomes suddenly old, and encounters evergreen troubles of sustainability, responsibility, and accountability. Mark-to-market accounting, claimed to be fair value, is suddenly dismissed once market prices disruptively decrease and financial markets experience systemic failures⁴. As many scholars have recently acknowledged, reforms

³ Issuances from governments and other entities are neglected here for sake of simplicity.

⁴ On 3 October 2008, the so-called 'Financial Institutions Bailout Bill' (Paulson Plan) included two sections (n° 132 and 133) relating to fair value (marked-to-market) accounting, the first giving authority to the SEC to suspend this method of accounting for reasons of public interest and investors protection, the second mandating further studies on: its effects on balance sheets of firms, impact on the quality of financial information, role on bank failures in 2008, process used by the Financial Accounting Standards Board (FASB) in developing related accounting standards, advisability and feasibility of modifications to such standards, and alternative accounting standards to those already in place concerning fair value. Analogous decisions were taken by EU authorities.

are necessary, in order to protect shareholders as well as other stakeholders, but also communities and nature at large.

Together with architectural and managerial changes, new beliefs and ideas were crucial in the recent ascension of “shareholder value”. Remedying the current impasse, then, may require not only careful exercises in policy-making, but also some theoretical changes. Received policies and the whole concern with “corporate governance” and disclosure have been framed by a limited understanding of what financial markets and firms are, can and ought to be. Therefore, path-breaking analyses may be concerned with criticising received patterns of thought, in order to provide a different understanding of financial markets and the firm. This paper engages this theoretical provision by drawing upon the concept of the firm as an “enterprise entity”, which has significant implications for governance and disclosure.

The rest of the paper is organised as follows. First, the framework based on the concept of the firm as an enterprise entity is summarised. Later, two alternative views on the firm, jointly creating shareholder value rhetoric -namely the “black box” and the “proprietor entrepreneur”-, are criticised as “daydreams”. Finally, this critique leads to significant implications for the governance and disclosure of the firm as an enterprise entity.

II. THE FIRM AS AN ENTERPRISE ENTITY

Following Biondi (2005) and Biondi et al. (2007), the idea of the firm as an enterprise entity implies a comprehensive approach that integrates economics, accounting, and law. This approach comprehends the firm as a managed dynamic system (Figure 1) jointly constituted by two basic relationships: the enterprise core that denotes the management of an economic organisation mediated by an accounting system; and its governance that makes management accountable to various stakeholders for enterprise income and results.

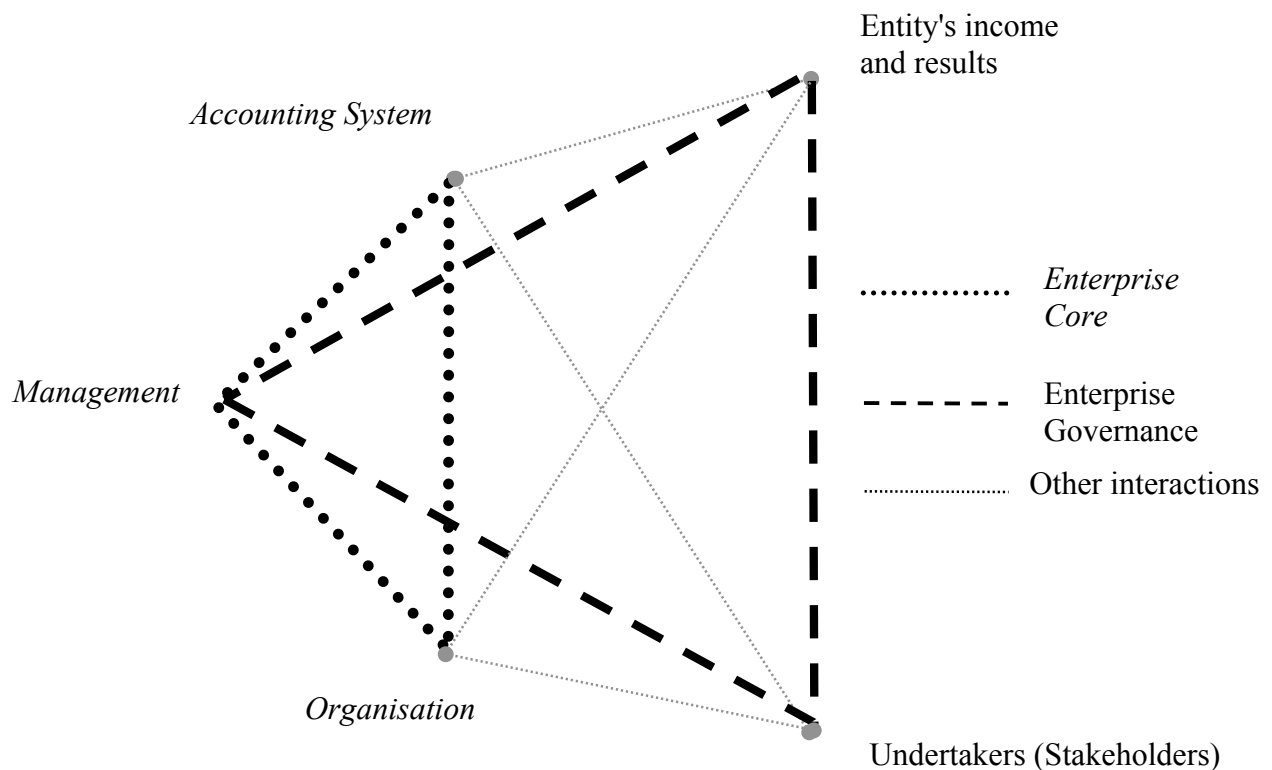


Figure 1 - The Firm as an Enterprise Entity

This functional system of the firm is further characterized by different “structures of production” (in Coase, 1992’s words): institutional, organizational or epistemic (respectively related to the place and role of institutions, internal organization, and knowledge within the firm). The concept of the enterprise entity aims to frame together these institutional, organizational, and epistemic (cognitive) dimensions of the business enterprise.

Theoretically speaking, the entity approach to the firm reacts to a “sense of lacking” in the current state of socio-economic theory and practice. Notwithstanding its theoretical and heuristic advances, a market bias can be recognised in economic and sociologic approaches to business activities. Received understandings of socio-economic dynamics appear to excessively focus a distinctive individualistic vein. They neglect therefore the special socio-economics of institutions and organisations that frame and shape business activity of the firm. Nevertheless, these limited

views have been influential on actual business practices and institutional frameworks that have been advocated and applied in recent decades. Whereas, the enterprise entity approach enters the field by developing insightful suggestions from: H. Simon, who addresses the special economic organisation of the firm as a dynamic system; M. Shubik, who deals with the relationship between accounting and the critique of equilibrium economics (neoclassical) of the firm; R. Coase, who explores the accounting contribution of accounting to the theory of the firm; and A.A. Berle Jr., who criticises the classical view of the proprietor entrepreneur under the economic and financial conditions that characterize(d) the 20th century. In addition, the enterprise entity perspective takes inspiration from some traditions of thought (from economics, accounting, and law) that have already tried to understand the business firm and its impact upon economy and society: especially the continental European tradition of accounting and economics, and the old American, and European, institutional economics.⁵ Together, these perspectives offer some backgrounds for the view of the firm as an entity, a whole, a dynamic system. In particular, such a view integrates law and economics with accounting under the comprehensive notion of the firm as an “enterprise entity” that is already common to all three scholarly and professional communities. According to this approach, the firm is then:

- a) Understood as an enterprise entity,
- b) Characterized by a peculiar economic and monetary process (dynamic system), which
- c) Generates income to the firm,
- d) Whilst is confronted with the actual dynamics and complexity of socio-economic reality (unfolding and undetermined).

The entity approach has consequences and implications for the system of governance and disclosure. Accordingly, the accounting system is an integral part of the firm’s system of management, governance and regulation, a part that demonstrates the joint implications of economic, accounting, and legal matters within the firm. In a business affair fraught with unfolding changes coupled with asymmetries of resources, access, control and information, the accounting system copes with the economic and monetary process generated by the whole enterprise, and defines the representation of its capital (assets and liabilities) and income (revenues and costs). In this way, the accounting system allows this special process to exist and function autonomously from and interactively with share-holding and trading. It lies therefore at the core of the continuity and sustainability of the enterprise entity, and mediates immanent conflicts of interests among various stakeholders, including shareholders.

This comprehensive understanding of the firm contrasts with the shareholder value rhetoric that frames the firm with either financial markets and/or ownership claims. The first frame reduces the whole firm to a “black box,” whilst the second frame submits it to a lonely “proprietor entrepreneur.” The following section will provide a comparative analysis of these three approaches to the special economics of the business firm.

⁵ References to recent advances will be provided in the following.

III. BEHIND SHAREHOLDER VALUE RHETORIC

The view of the firm as an enterprise entity contrasts with two alternative views, which jointly compose the “shareholder value” rhetoric. The first view aims to make the firm entirely dependent on external markets, whilst the second view purports to submit it to legal ownership rights (Table 1).

Table 1 - Three distinctive views of the firm

	Enterprise entity	Black Box	Proprietor Entrepreneur
Concept	A complex dynamic system or whole	A shallow nexus of (market) prices or (complete) contracts	Ownership and wealth
Functioning	A specific economic and monetary process	A mechanical link between price and cost for each product separately (marginal cost pricing)	A legal and economic device for the solitary owner
Purpose	Generation of income to the firm, related to the satisfaction of individual and social needs	A unique objective of “profit maximisation”	A unique objective of generation of rents from wealth
Conditions	Under actual dynamics and complexity of socio-economic reality (unfolding and undetermined)	Under idealised conditions abstracted away from hazard and context	Under ideal conditions of complete contracting and enforcement

A. DAYDREAMING THE FIRM AS A “BLACK BOX”

Some endorsers of shareholder value more or less explicitly refer to the conception of the firm as a “black box”. This view relates to the neoclassical economic theory that understands the firm on a market basis. The inner intricacies of the business are made “black,” since only external market prices for inputs (including fictitious commodities such as land, money, and human work) and outputs matter in the market economics of the firm. In fact, the history of economic thought sheds some light into the box. Accordingly, the firm no longer appears to be empty or black, because this market view of the firm provides a peculiar understanding based upon:

- a) A shallow nexus of (market) prices or (complete) contracts, characterised by
- b) A mechanical link between price and cost for each product separately (marginal cost pricing), and
- c) A unique objective of “profit maximisation” - a profit that shall be null, like in the

punishment of Tantalus,

- d) Under idealised conditions abstracted away from time, hazard and interaction.

In a sense, the firm *as such* disappears in this market framework, replaced by a system of efficient market pricing. The whole firm no longer has an impact on economy and society. If its managers disclose information about their activity and the business incomes generated, they discharge their responsibility towards markets which they must follow. Markets (especially the Share Exchange) are then the cutting edge for the economics of the firm.

B. DAYDREAMING THE FIRM AS A “PROPRIETOR ENTREPRENEUR”

Some advocates of shareholder value have another daydream, which understands the firm as a legal-economic device of its “proprietor entrepreneur”.⁶ This time, the firm disappears in favour of the lonely captain of his own business. This capitalistic hero alone bears the risks, and alone undertakes the management of the enterprise. The firm and its personnel are nothing but his instruments, playing no role in decision-making, organisation, or control, since *all that does matter* is the solitary owner of the firm. This approach understands the firm as:

- a) A form of ownership and wealth, characterised as
- b) A legal and economic device for the solitary owner,
- c) With a unique objective of generating rents from that wealth,
- d) Under ideal conditions of complete contracting and perfect enforcement.

Once again, the firm *as such* disappears in this ownership framework, replaced by a system of enforceable ownership rights. Again, the whole firm has no impact on economy and society. If its managers disclose information about their activity and the business incomes generated, they discharge their responsibility towards the owner whom they must obey. Ownership is then the cutting edge for the economics of the firm under this approach.

C. THE PROBLEMS WITH DAYDREAMS DRIVEN BY SHAREHOLDER VALUE

However influential and significant these daydreams are, they involve problems that go beyond the emotional (and political) reactions for or against them. These views grapple with the reality of business firms as they exist and function in economy and society. For instance, firms combine a number of corporate and other legal arrangements (including contracts and regulations concerned with labour, financial security, foods & drugs, environment, anti-trust), which collectively create the triple separation of ownership, control and *management* (not only between

⁶ Reference is made here on such individualist assumption since the presence of several proprietors entrepreneurs would integrate an interactional holistic dimension that this approach aims to exclude, see also Hirshleifer (1987).

ownership and control), already recognised by Berle and Means' seminal work. In order to cope with this legal-economic web, management does not rely exclusively on market pricing, but maintains *accounting* systems that are modes of looking inside the ongoing enterprise process, i.e., to know, organise and govern that process.

Both the "proprietor entrepreneur" and the "black box" viewpoints grapple with this special legal and accounting field generated by the enduring economy of the business firm. In particular, law and accounting provide evidence for the functional distinction between the firm and its "owners". The legal structure of the firm involves various legal forms (including corporations) that hold and possess the assets, enter into contracts and obligations, and have priority rights in flows, incomes and results. Furthermore, through the working of the accounting system, prudential regulation restricts dividend payments and equity repayments from the firm to shareholders or partners, whilst fiscal regulation establishes the income tax based on the net accounting earnings for the period.⁷ Therefore, *ownership by isolated individuals* is framed and shaped by a "phantom" entity that the idea of a "solitary owner" cannot cope with.⁸

The "black box" representation does not capture the entity phantom. This is because the latter view assumes that the price system (the market) is sufficient to understand, organise and regulate the business activity of firms. The firm would be neutral, and institutions would not matter. Accordingly, no business inflows and outflows would exist but (efficient) market prices. Unfortunately, the firm (and its dynamics) does matter in the economic and monetary process. It generates an epistemic, organisational and institutional field that has a distinctive impact on the process of generation of incomes that all stakeholders are interested in (Sunder 2008). Once again, the working of the accounting system provides the legal-economic basis for this theoretical claim. For the accounting system *defines* revenues and costs of the period through accruals and other technicalities that encompass the monetary dimension. Contrary to the "black box" view, the firm is not a simple "nexus of monetary flows (prices)", since the accounting system goes beyond the cash basis through its definition and application of "accruals".

Moreover, prior financial literature has argued for the influence of taxation and dividend policies on shareholder value (Modigliani and Miller 1963; Gordon 1959; Lintner 1956). As a matter of fact, the accounting representation constitutes the basis of taxation and dividends' distribution. This accounting basis is not a market basis; rather it allows the accounting system to both establish net earnings (that may be partly or fully distributed to shareholders or partners), and to determine the tax basis, as well as the maintenance of prudential ratios, executive compensation, and so on. More generally speaking, the working of the accounting system provides a *common representation* of business capital and income to the firm (Biondi 2005 and 2008 for further details). The accounting system copes with the special *process of becoming* by accounting for the firm *as an entity*. Such enterprise process is concerned with uncertainties, bounded knowledge, potential and actual mistakes, and mis-organisation. It is then *unfolding* and *undetermined*. Confronted with this process, the accounting system becomes a special *mode of representing*,

⁷ Avi-Yonah (2008) discusses the legal-economic foundations of taxation under different conceptions of the business firm. See also Kleven, Kreimer and Saez (2009).

⁸ The legal debate on the nature of public corporation deals with this problem involved by focusing on individual entrepreneurship and ownership. The notion of enterprise entity aims to go further by understanding the legal structure of the firm as a system of multiple arrangements including corporations (Strasser and Blumberg 2008, Berle 1947).

organising, and regulating the ongoing economic organisation and its becoming. It deals with price formation, carried immobilizations (investments), overhead allocation, and all the concerns which lay at the core of everyday business activity through time, space, and interaction.

In conclusion, the firm and its accounting system do not constitute a mere “nexus of market prices”, and the accounting system becomes a constitutive part of the “institutional structure of production,” which can no longer be reduced to “ownership rights” alone. This leads to an understanding of the firm as an enterprise entity characterised by its management, organisation and accounting system, which jointly play an active role in the economic and monetary process of creating and allocating resources (production and distribution of wealth), with accounting mapping and mediating the business processes that link organisation and management into the enterprise field through hazard, learning, and interaction. This role has significant implications for governance and disclosure, which will be discussed by the following section.

IV. GOVERNANCE AND DISCLOSURE OF THE FIRM AS AN ENTERPRISE ENTITY

Notwithstanding the mentioned factual problems with the market and the ownership view, we are ever free of the thinking that firms *should* be dominated by either markets or owners. This has been the main attitude for the last three decades of corporate governance and regulation, and it is the basis for convergence among conceptual frameworks for financial reporting fostered by American and International accounting standards-setting bodies (Bignon et al. 2004; Biondi and Suzuki 2007). As Jensen (1983, p. 320a) candidly argues, “in the end, of course, we are all interested in normative questions; a desire to understand how to accomplish goals motivates our interest in methodological topics and in positive theories.”

The Friedman’s “what if” argument might be further advocated as a defence of this normative attitude. However, whilst a theory is obviously concerned with *what is* and *should be*, it also concerns *what can be*. Therefore, it ultimately provides an overall understanding of facts and potentials. Whether it has some predictive power or not, the overall understanding that a theory provides is fundamental whenever recommendations are expected. Otherwise, poor policies may result for economy and society.

Regarding shareholder value rhetoric, recent crises and scandals provide evidence for the limited understanding of this framework (Clarke 2008). The theoretical choice of neglecting the firm *as such* has eventually transformed the firm in an unaddressed *field of overwhelming power*. Advocates of shareholder value have been concerned with public (Governmental) powers (Shleifer 1998, Mattei and Nader 2008, 42 ff.), but private (financial) powers may also raise constitutional economic and societal concerns. As a consequence of such narrowed frame of analysis, the firm as a phantom has been haunting the socio-economic realm. Headlines reporting massive shortcomings have revealed how powerful this phantom can be.

Contrary to the voluntary myopia advanced by advocates of shareholder value, the view of the firm as an enterprise entity takes the firm seriously. Pursuant to this view, governance and regulation of businesses upgrade from the *logic of ownership and financial markets* to accountability⁹. The firm as such no longer disappears from economy and society, rather it plays an active role in the process of creation and allocation of resources. If managers disclose information about the business activity and the business income generated, they would then provide information about the results that have been generated by the enterprise entity under their fiduciary responsibility, and accounted for by the accounting system. The management of the enterprise entity becomes the cutting edge for the economics of the firm under this approach, with significant implications for enterprise governance and disclosure.

A. IMPLICATIONS OF THE ENTERPRISE ENTITY VIEW FOR GOVERNANCE AND DISCLOSURE

The received view of governance and financial disclosure is driven by the rhetoric of shareholder value (Biondi and Chambost 2008; Biondi and Rebérioux 2008), which in turn relies on efficient financial markets and shareholder ownership of the firm. The “institutional structure of production” is then expected to comply with this framework by making operational (and enforceable) the shareholders’ claims on governance and disclosure. However, even if coupled with financial market trading, ownership alone cannot grasp the whole institutional structure (system) of production. This structure is concerned with *sustainability, accountability and responsibility* within the special field of the ongoing business firm. Accounting systems factually comprehend this structure and therefore become a special mode for making the firm accountable. Accounting may then be understood as a mode of representing, organizing and regulating the socio-economic system of the business firm and its institutional, organizational, and cognitive patterns and interactions. Even in the absence of the disciplines of market and ownership, accounting and accountability assume an active role in governing and regulating management and the organized activities of the enterprise entity as a whole.

In turn, the firm itself may be recognised as a special field fraught with unfolding changes coupled with asymmetries of resources, access, control and knowledge among different stakeholders and the management. The field of the firm implies interactional holistic concerns that cannot be addressed at the individual or the contractual level. In particular, price formation, carried immobilizations, overheads allocation are distinctive features of this field through time and time.

In a world of pure law, every business activity is controlled ex ante by external forces driven by immediately enforceable rules and contractual claims. A striking analogy exists with the world of perfect and complete markets, where prices suffice to secure the socio-economic interests for each stakeholder linked to the business. Every business activity is controlled ex ante by external

⁹ As a matter of fact, these logics play simultaneously in the actual field of the business firm, and constitute dynamic sources of tensions, conflicts, and transformations in a way. Here, we are arguing for a preference or hierarchy between them as focus and principle of reference.

forces driven by the price mechanism and monetary incentives. In contrast, in a world of complex organizations concerned with unfolding changes and bounded rationality, every ongoing entity involves a financial-economic core existing beneath the chrysalis provided by contracts and prices. Within this core, contracts are necessarily incomplete, and markets are never perfect. In the void left by incompleteness and market failures, the firm acquires a dynamic and collective dimension that leads to a field of power (Sakatera and Sawabe 2000; Biondi et al. 2007). As Berle early recognized, legalistic reasoning cannot deal with this power, because the formal conformity to rules may hide unfair behavior, fraud and abuses. This situation is at the very origin of the legal-economic meaning of the expression “equitable interest,” that is, a legitimate interest that the bearer might be unable to defend through contractual enforcement of rights and claims.¹⁰ The institutional process of protection (comprising governance and regulation) fills the void so as to address the “equitable interests” of stakeholders relying on the firm for the joint accomplishment of goals, but substantially, even though not formally, because they lack the contractual enforcement or market outward options. This protection requires a combination of principles and devices involving discretion and judgment. Principles lie at the core of that process, since they provide each actor (especially management and law court judges) with a clue to comprehending the socio-economic dynamics of the common concern and to undertaking a “fair” conduct of business. This conduct is “fair” because it takes into account “other people interests”¹¹ and thus has regard for the public interest at large. Fairness cannot be narrowly reduced to economic values, but ultimately ethical guidelines drive the choice and application of principles of reference for the social responsibility of business.

In this context, the institutional structure of the firm (including its accounting system) enters into the firm’s field as an accountability device for sustainability and responsibility of the joint business affair. Consequently, the enterprise entity view has five primary implications:

- 1) The entity should be understood as a “joint and becoming concern”, autonomous from stakeholders (including shareholders)¹²;
- 2) There is triple separation between ownership, and control, *and* management;
- 3) The impact of “absentee ownership” (and the difference between the legal and economic frontiers) must be considered;
- 4) The specific role played by the accounting system in the enterprise process;
- 5) The articulation between this enterprise process and the value (and valuation) of equity shares.

For matters of governance and disclosure, the enterprise entity constitutes a *joint and becoming concern* (point 1). Some legal and economic features define the firm’s economic autonomy and

¹⁰ Montagne (2006, 46 ff.) deals with the emergence of the notion of “equity” and “equitable interest” in trust regulation.

¹¹ According to Adam Smith, the management of the affairs of a public company is concerned with “other people’s money”, and this may eventually lead to negligence and profusion.

¹² This concept expands upon the notion of “going concern” that Commons had distilled from legal-economic practices as theoretical keystone of his institutional economics. The latter notion was utilised by early accounting entity theorists at least until the middle war period.

continuity beyond mere legal forms. In particular, shareholders have limited financial responsibility and benefit from an unconstrained right of “exit,” whilst prior legal protection is granted to other stakeholders against shareholders in some cases. Moreover, through its legal structure (comprising companies and mandates and other legal forms and devices), the entity acquires legal capacity to enter contracts and obligations, hold autonomous (collective) property and possess assets, and have priority in controlling cash flows, incomes and results.

These features suffice to separate shareholders from the corporation that has issued their shares, and they distinguish the corporation from the whole business enterprise (see also Segrestin and Hatchuel 2008). As analysed by Strasser and Blumberg (2008), enterprise groups feature the financial structure and reinforce this separation. All this implies the separation between, on the one hand, shareholding, and, on the other hand, *management* (namely possession). Only the management is entitled to dispose of assets and cash flows and to organise the activity of the enterprise (point 2). This further implies the special status of managerial power that requires an institutional process of control in order to frame and supervise that power. Therefore, the notion of “absentee ownership” (Veblen) is critical (point 3). It means that a large number of shareholders hold only a small part each of the shareholders equity value, and are excluded from actual decision-making, whilst influential insiders (including significant minority shareholders, investment funds and financial intermediaries) can control the firm *at a distance*, by influencing executive managerial decision-making and the fabric of the rules-making (Aglietta & Rebérioux 2005; Froud and Williams 2007).

Theoretically speaking, legal forms -related to corporate frontiers- are distinct from the socio-economic frontiers of the firm, that is, the economic substance of the business enterprise. This is the primary reason that accountants looked beyond legal forms in order to accounting for the business enterprise on a more appropriate basis (point 4). In turn, this implies *the separation between the accounting system and the value of equity shares* (point 5). Instead of reporting about the firm as a proprietary placement, modern accounting systems are structured to provide relevant and reliable representations connected with institutional regulations regarding dividend payments and repayments of shareholders’ equity, and related to retention of net earnings as sources of « financing » (Lazonick & O’Sullivan 2000). This accounting separation is further related to the fact that, before liquidation, the enterprise entity does not have to repay shares at their value (either market or accounting value), since shareholders must sell them through the Share Exchange in order to recover their investment. This way, the institutional structure of the firm acts as a shield that locks-in financial resources which have been provided to the firm and are required for the continuity of the enterprise through time (Blair and Stout 1999).

B. THE ENTERPRISE ENTITY AND SHAREHOLDERS’ CLAIMS

Taking into account the working of the firm as an enterprise entity may radically change the relationship of the firm with potential and actual shareholders, especially in relation to matters of governance and disclosure. According to the (narrow) definition of Shleifer and Vishny (1997, 737), “corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment,” this return being either a market return (capital gains between buying and selling prices), or a comprehensive return including dividends.

However, the market value is external to the enterprise process (according to point 5 above), and the distribution of dividends is residual and constrained by net earnings and other figures accounted for by the accounting system (point 4 above). Furthermore, from the viewpoint of the enterprise entity, shareholders equity is a special source of financing, as Schumpeter – translated and commented by Biondi (2008) – early advocated. Accordingly, the accounting system may recognise the shareholders' claim on the business incomes generated by the enterprise entity as a cost and an allocation.

This mode of remuneration of shareholders relates to the understanding of both the status and role of shareholding and its relationship to the firm as an enterprise entity. Several accounting techniques are available for recognising this remuneration: for example, by defining a “shareholders' equity interest” (Anthony) *based on the actual financial funds provided in the past*, or by settling the shareholders' share (interest) of the overall net earnings (as the German law does). This differs from the definition of shareholder value provided by “Economic Value Added” (EVA[®], a trademark deposited by Stern Stewarts, a consultancy firm) and other market-based metrics (Froud et al. 2000). Technically speaking, all these metrics are variants of discounted present value based on prospective cash flows to shareholders. In particular, EVA[®] may be formalised as follows:

$$EVA = (ROE - k) * \text{Shareholders' Equity} = \text{Net Earnings} - k * \text{Shareholders' Equity}$$

Where *ROE* is the usual “Return On Equity” (the ratio of Net Earnings on Cumulated Shareholders' Equity, including reserves)¹³, and *k* is the estimated market cost of shareholder capital. This definition of shareholder value implies that the whole “residual income” (if positive) should be allocated to shareholders.

In contrast, the “shareholders' equity interest” (SEI) may be formalised as follows¹⁴:

$$SEI = i * \text{Cumulated Shareholders' Funds}$$

Where *i* represents the *cost* of shareholders' funding (agreed by management, directors, shareholders' meeting, statutes, by-laws, financial contracting or other institutional arrangements) as a source of financing, and the “cumulated shareholders' funds” implies the separation between the funds committed by shareholders (including undistributed past SEIs) and the entity equity, mainly composed by cumulated net earnings after SEIs (Anthony 2003; Staubus 1959). This definition of shareholder remuneration implies that only a part of the whole residual income may be allocated to shareholders, the remainder being available for reinvestment or donation.

More generally speaking, the EVA metrics fits the fair *value* accounting perspective that reflects the shareholder value drift in accounting regulation, whilst the shareholders' equity interest (SEI) improves on traditional accounting systems based on historical *cost* and revenue generated by the

¹³ Financial analysis sometimes estimates shareholders equity at its market value.

¹⁴ An alternative formulation is available as share of net earnings.

firm through time. Shareholder value replaces the nominal financial capital maintenance by a new concept that includes the maintenance of the opportunity cost and defines shareholder equity in terms of capacity to earn the current market rate of return¹⁵. Moreover, shareholder value is at odds with justifying supplementary accounting systems for environmental and societal issues, since the social responsibility of business is anything but profits as usual (echoing the Friedman's adage) under this approach. On the contrary, the enterprise entity approach may easily integrate a more comprehensive approach to accountability of business affairs. Examples of voluntary disclosure regarding this matter already exist worldwide, and some regulations make it compulsory in France and Germany, since 2002.

V. CONCLUDING REMARKS

In conclusion, a new institutional approach is required to better understand the firm as an institution and an organization having a distinctive impact on economy and society. This perspective implies a new inter-disciplinary approach that links economics, accounting and law by a unique common notion: the firm as an enterprise entity (Biondi et al. 2007). This theoretical development is original, but is not isolated in the current debate. Baker, Gibbons and Murphy speak about the management of off-contractual relations to understand the socio-economic core of the firm, whilst Rajan and Zingales are concerned with the integrity of this core against the "dark side of the ownership". Especially Blair and Stout claim for the autonomy and continuity of the legal-economic entity framing various stakeholders, including shareholders, and inscribe this point in a constructive critique of financial market efficiency (Stout 2003 and 2005).

The enterprise entity view understands the firm as a whole, a dynamic system of relationships, not only contractual or bargaining. From this perspective, order and disorder, efficiency and waste, honesty and guile, development or distress have much to do with the structures of such relations (more than what existing theories have already recognized). In particular, this comprehensive view provides valuable insights to better understand (i) the inner economic nature of the firm, (ii) the separation between ownership, management, and control, and (iii) the related systems of enterprise governance and disclosure.

¹⁵ IASC (1997, Chap. 6, §2.4-2.7) suggested this conception for financial assets and liabilities.

REFERENCES

- Aglietta, Michel and Antoine Rebérioux. 2005. *Corporate Governance Adrift. A Critique of Shareholder Value*. Cheltenham (UK): E. Elgar Publishing.
- Anthony, Robert N. (1983), *Tell it like it was: a conceptual framework for financial accounting*, USA: Richard D. Irwin Inc., 1983.
- Avi-Yonah, Reuven (2008), "Taxation, corporate social responsibility and the business enterprise", paper presented at "Governing the Business Enterprise: ownership, institutions and society", EAEPE International Conference, CNAM, Paris, 22 and 23 May, <<http://eaepe.cnam.fr/>>
- Baker, George, Gibbons, Robert, Murphy, Kevin J. (2001), Bringing the market inside the firm?, *American Economic Review*, 91 (2), Papers&Proceedings, May 2001, pp. 212-218.
- Baker, George, Gibbons, Robert, Murphy, Kevin J. (2002), Relational contracts and the theory of the firm, *Quarterly Journal of Economics*, 117 (1), February 2002, pp. 39-84.
- Berle, A. Adolf Jr. (1947) "The Theory of enterprise entity," reprinted in Y. Biondi et al. (2007), quoted.
- Berle, A. Adolf Jr. (1965), The Impact of the Corporation on Classical Economic Theory, reprinted in Y. Biondi et al. (2007), quoted.
- Berle, A. Adolf Jr., and Means, Gardiner C. (1932) *The Modern Corporation and Private Property*, New York, NY: The Macmillan Co.
- Bignon, V., Biondi, Y. and Ragot, X. (2004) 'An Economic Analysis of Fair Value: The Evolution of Accounting Principles in European Legislation, with a commentary by R.G. Barker (Cambridge University and IASB Scientific Committee) and a rejoinder by the Authors', *Prisme*, 4, Cournot Centre for Economic Studies (formerly Saint-Gobain Centre), France. Available at <<http://ssrn.com/abstract=879273>>.
- Biondi Yuri (2005), "The Firm as an Entity: Management, Organisation, Accounting", Working Paper of Dept. "Economia aziendale", n° 46, Brescia University, August 2, 2005. <<http://ssrn.com/abstract=774764>>.
- Biondi Yuri (2006), "Accounting and the economic Analysis of the Firm as an Entity", in M. Dietrich (2006) ed., *Economics of the Firm. Analysis, evolution, history*, NY and London: Routledge, chapter 4: 65-87.
- Biondi Yuri (2008), Schumpeter's economic theory and the dynamic accounting view of the firm: Neglected pages from the *Theory of Economic Development, Economy and Society*, 37 (4). Abstract available at <
- Biondi Yuri and al. (2007) eds., *The Firm as an Entity: Implications for Economics, Accounting, and Law*, NY and London: Routledge. Book presentation accessed at <<http://www.ssrn.com/abstract=983029>> on January 20, 2007.
- Biondi Yuri, Chambost Isabelle (2008), « Gouvernance, transparence et encastrément cognitif

des marchés financiers : Le cas des analystes financiers » [Governance, transparency and cognitive embeddedness: the case of financial analysts], paper presented to the 20th Asian Pacific Conference On Accounting Issues (www.apconference.org), Paris, 9-12 November. Forthcoming in *Revue Française de Gouvernance d'Entreprise*.

Biondi Yuri, Reberioux Antoine (2008), "The Governance of Intangibles: Rethinking Financial Reporting and the Board of Directors" (October 17, 2008). Paper presented to the IPR Conference, "Governance, Intangibles & Corporate Social Responsibility", Collegio S. Chiara, University of Siena, 29 September 2008. Available at SSRN: <<http://ssrn.com/abstract=1288707>>

Biondi Yuri, and Suzuki Tomo (2007) eds. "The Socio-Economics of Accounting." *Socio Economic Review*, (5) 4, special issue.

Blair M. Margaret, Stout A. Lynn (1999), "A team production theory of corporate law", *Virginia Law Review*, 85 (2), 248-328. Available at: <<http://papers.ssrn.com/abstract=425500>>

Boyer Robert (2000), Is a finance-led growth regime a viable alternative to Fordism? A preliminary analysis, *Economy and Society*, 29 (1), 111-145.

Clarke Thomas (2004) ed., *Theories of Corporate Governance*, NYC and London: Routledge.

Clarke Thomas (2008), The ownership perspective and beyond: a critique of the anglo-american model of corporate governance, paper presented at "Governing the Business Enterprise: ownership, institutions and society", EAEPE International Conference, CNAM, Paris, 22 and 23 May, <<http://eaepe.cnam.fr/>>

Coase, R.H. 1990. Accounting and the theory of the firm. in Y. Biondi et al. eds. 2007 - quoted.

Coase, R.H. 1992. "The Institutional Structure of Production." *American Economic Review*, 88 (4): 713-719.

Deeg Richard and Jackson Gregory (2007), Towards a more dynamic theory of capitalist variety, *Socio-Economic Review*, 5(1):149-179

Froud J. and Williams K. (2007), "Private equity and the Culture of Value Extraction", CRESC Working Paper Series, n°31.

Froud Julie, Haslam Colin, Johal Sukhdev and Karel Williams (2000), Shareholder value and financialization: consultancy promises, management moves, *Economy and Society*, 29 (1), 80-110.

Gordon, Myron (1959), "Dividends, Earnings, and Stock Prices." *Review of Economics and Statistics* 41: 99-105.

Hirshleifer Jack (1987), "Investment decision criteria", in: The new Palgrave. A Dictionary of Economics, London: McMillan.

Jensen C. Michael (1983), Organization theory and methodology, *The Accounting Review*, 58 (2), April, pp. 319-339.

Keynes John Maynard (1936), *The General Theory of Employment, Interest and Money*,

Macmillan.

Kleven, H.J., Kreiner, C.T., and E. Saez (2009), "Why Can Modern Governments Tax So Much? An Agency Model of Firms as Fiscal Intermediaries", mimeo, May.

Lazonick William, O'Sullivan Mary (2000), Maximising shareholder value: a new ideology for corporate governance, *Economy and Society*, 29 (1), 13-35.

International Accounting Standards Committee – IASC (1997) "Accounting for Financial Assets and Financial Liabilities", Discussion paper, London.

Lintner, John (1956), "Distribution of Incomes of Corporations among Dividends, Retained Earnings and Taxes." *American Economic Review*, 46: 97–113.

Mattei Ugo, Nader Laura (2008), *Plunder. When Rule of Law is Illegal*, Oxford (UK): Blackwell Publishing.

Modigliani F. et M.H. Miller (1963), "Corporate Income Taxes and the Cost of Capital", *American Economic Review*, 53 [3], pp. 261-297.

Polanyi, Karl (1947), Our Obsolete Market Mentality, *Commentary*, 13, p. 109-117, reprinted in K. Polanyi (1968), *Primitive, Archaic and Modern Economies*, edited by G. Dalton, Doubleday & Company Inc.

Rajan G. Raghuram, Zingales Luigi (1998), Power in a Theory of the Firm, NBER, in: *Quarterly Journal of Economics*, CXIII, pp. 387-432.

Segrestin Blanche, Hatchuel Armand (2008), The corporation against the enterprise: Can research foster new models of collective management?, paper presented at "Governing the Business Enterprise: ownership, institutions and society", EAEPE International Conference, CNAM, Paris, 22 and 23 May, <<http://eaepe.cnam.fr/>>

Shleifer Andrei (1998), State versus private ownership, NBER wp w6665, july 1998.

Shleifer Andrei, Vishny W. Robert (1997), A Survey of Corporate Governance, *Journal of Finance*, LII (2), june 1997, pp. 737-783.

Shubik, Martin 1993. Accounting and its Relationship to General Equilibrium Theory. in Y. Biondi et al. eds. 2007 - quoted.

Simon, A. Herbert (1991), "Organizations and markets," in Y. Biondi et al. eds. 2007 - quoted.

Stout L. (2003), "The Mechanisms of Market Inefficiency". *Journal of Corporation Law*, vol.28, 635-669, available at <<http://ssrn.com/abstract=523747>>

Stout L. (2005), "Inefficient Markets and the New Finance", *Journal of Financial Transformation*, vol.14, 95-105. Available at SSRN: <<http://ssrn.com/abstract=729224>>

Strasser A. Kurt, Blumberg I. Phillip (2008), Legal Models and Business Realities of Enterprise Groups – Mismatch and Change, paper presented at "Governing the Business Enterprise: ownership, institutions and society", EAEPE International Conference, CNAM, Paris, 22 and 23 May, <<http://eaepe.cnam.fr/>>

Sunder Shyam (2008), Accounting for Enterprise Income and Value, paper presented at "Governing the Business Enterprise: ownership, institutions and society", EAEPE International

Conference, CNAM, Paris, 22 and 23 May, <<http://eaepe.cnam.fr/>>

Veblen Thorstein (1923), *Absentee Ownership*, B.W. Huebsch, NY: 1954.

Weinstein Olivier, Coriat Benjamin (2008), Intellectual property regimes, firms, and the commoditization of knowledge, paper presented at “Governing the Business Enterprise: ownership, institutions and society”, EAEPE International Conference, CNAM, Paris, 22 and 23 May, <<http://eaepe.cnam.fr/>>

Williams Karel (2000) ed., From shareholder value to present-day capitalism, *Economy and Society*, 29 (1), February, special issue.

Staubus J. George (1959), “The Residual Equity Point of View in Accounting”, *The Accounting Review*, 34 (1) Jan., pp. 3-13. Stable URL: <<http://www.jstor.org/stable/241135>>